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## Russian Federation

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### Russian Trade Law Equals Transparency?

**Report Categories:**

Retail Food Sector

**Approved By:**

Deanna Ayala, ATO Director

**Prepared By:**

Olga Kolchevnikova, Marketing Specialist

**Report Highlights:**

The Russian Federal Law on Trade came into force on February 1, 2010. The Law is aimed at creating transparent conditions of cooperation between suppliers and retailers and boosting competition in the retail sector. The Law contains strict antimonopoly regulations, such as capping store openings once a retailer reaches a 25 percent market share threshold within a city or municipal region, a 10 percent limit on retailers' bonuses paid by suppliers, and payment terms regulating how fast a retailer has to pay for goods with a certain shelf life, among others. The Law stipulates that the terms and conditions of food product supply contracts shall be brought into accord with requirements of the Law within one hundred eighty days from the effective date. Russian retailers repeatedly expressed worries about overregulation of commerce, pointing to the risk of a hike in prices and a sharp decrease in the assortment of foodstuffs in Russia.

### General Information:

At the end of 2009 the Russian Parliament approved a Federal Law on Trade which it hopes will make pricing more predictable and transparent, boost competition in the retail sector and make relations between retailers and suppliers more transparent. The law, which has been five years in the making, came into force on February 1, 2010. An English translation of the text of the Federal Law on Trade may be found in Attachment 1 to this report. The Russian text of the Law is on the site:

<http://www.rg.ru/2009/12/30/torgovlya-dok.html>

The Law contains strict norms on antimonopoly regulation. It stipulates that chains with a market share of 25 percent or more within the boundaries of a municipality or a city district and also the cities of federal importance (Moscow and St. Petersburg) would be prevented from opening new stores in that area. This part of the law was phased in from February to July and as of July 1, 2010 and is now fully in effect.

Many see this as a barrier for big retailers like X5 and Magnit to opening new stores, especially in small towns, as a retailer can breach the threshold by opening a single store (hypermarket). Sergey Galitsky CEO of Magnit Retail Group is among those, he said, *"It's an anti-market measure. We are ready to submit to new conditions in order to open a store, but we are not ready for a total ban on new shops."* (Source: [www.rt.com](http://www.rt.com), 12/12/2009)

Pursuant to the Law, the definition of a trade chain is two or more stores under common control or common business name. It means that the stores owned by, for example, X5 operating under different brands such as Pyaterochka and Perekrestok represent the different chains.

According to Planet Retail estimates, the share of modern retail in Russia is 30 percent, versus an average of 80 percent in developed countries. The top ten Russian retailers have an aggregate market share of 13 percent. Assuming that the food retail industry grows at a 13 percent Combined Annual Growth Rate (CAGR) in 2008-14 (with the top ten retailers averaging a 20 percent CAGR over the same period), that would transfer into an aggregate market share of 19 percent in 2014.

Figure 1: Estimated market share of listed Russian retailers, 2008

USD mn	Moscow & Moscow region	Central region	North-West region	Volga region	Urals	South region	Russia
X5 Retail Group	4,476	278	2,713	781	368	178	8,794
market share, %	8.7%	1.1%	13.3%	2.0%	1.6%	0.7%	4.0%
Seventh Continent	1,237	123	193	n/a	53	n/a	1,605
market share, %	2.4%	0.5%	0.9%	n/a	0.2%	n/a	0.7%
Dixy	571	390	500	n/a	463	n/a	1,924
market share, %	1.1%	1.6%	2.4%	n/a	2.0%	n/a	0.9%
Magnit	222	1,212	282	1,521	105	2,719	6,061
market share, %	0.4%	5.0%	1.4%	3.9%	0.6%	10.5%	2.8%
Other	44,994	22,360	16,733	36,873	21,672	22,994	201,642
market share, %	87.4%	91.8%	81.9%	94.1%	95.6%	88.8%	91.6%
Russian Food Retail turnover	51,501	24,363	20,420	22,660	39,176	25,890	252,397

Source: GKS, Company data, VTB Capital Research

Implications for retail development in small towns are difficult to quantify given the fact that there is no data on how to calculate turnover and a big share of market activity is conducted on the grey economy. On a federal level, there are no implications for the food retailers that do not breach these criteria, while limitations on X5 Retail Group to grow its market share in St. Petersburg where it already controls some 30 percent (including Paterson) do exist. According to Vedomosti and Kommersant, the Federal Antimonopoly Service (FAS) proposes that retailers' market share for purposes of the antimonopoly provision of the retail law be calculated annually using data gathered by Rosstat. Retail sales turnover for purposes of the antimonopoly provision will account only for food items. The methodology proposed by the FAS must be approved by the Ministry of Economic development and the Government.

Another topic of the Law is the entry fee which suppliers pay to retailers to get their products on shelves. The Law limits the so-called "bonuses" that suppliers are asked to pay to retailers to a maximum of 10 percent of sales.

Currently the so-called bonus to retailers can be as much as USD 5000 for a product. The new law will put a stop to the practice but according to Lev Khasis, President of X5 Group, Russia's largest retailer, customers will ultimately pay more. *"The intention of this law is to increase the profitability of suppliers and to increase the level of operational expenses of chains. Who will pay for this? I know only one source – wallets of customers."* (Source: [www.rt.com](http://www.rt.com), 12/12/2009)

*"Of course, the supply contracts for 2010 will not include illegal bonuses - for example, for a place on the shelf or for a listing (the output of the new brand), but nothing prevents the retail chain to include these fees into individual contracts for services",* a Head of major Russian distributor of alcohol products said. *"If the supplier pays a retail chain more than the allowed bonus, e.g. 15 percent, then the retailer can specify the 10 percent bonus in the supply contract, while the remaining 5 percent will take the form of discount on the purchase price."* (Source: [www.rt.com](http://www.rt.com), 12/12/2009)

Suppliers are not worried - they say the big popular brands will boost their share in the shops, stimulating demand through advertising. But smaller producers will not be able to compete and may have to sell their products under a chain's private labels. Musheg Mamikonyan, President of the Russian Meat Union welcomes proposals to boost the power of suppliers: *"Only those who abused their power will lose out. There are a number of big retailers who had been taking advantage of their position to make excessive profits at the expense of the suppliers. This law will make it harder for that to happen."* (Source: [www.rt.com](http://www.rt.com), 12/12/2009)

The Law fixes terms of payment for delivered goods, with restricted payment delays. Payment must be made to suppliers within a maximum of 10, 30 or 45 days, depending on the shelf life of the product. Retailers should also pay for domestic alcohol products within 45 days.

Analysts suggest that there is a limited downside risk from the proposed regulation on public listed retailers' working capital as days payable in these categories fall into the proposed limits (the average days payable for listed retail companies is 62 calendar days, or 45 banking days). However, experts consider that any deterioration in payment terms would be offset by price increases. Figure 2 shows the average days payable for listed Russian food retailers.

Figure 2: Average days payable for listed Russian food retailers, 2008

	X5 Retail Group	Magnit	Dixy	Seventh Continent
Days A/P (calendar)	71	50	56	70
Days A/P (banking)	51	36	41	50

*Source: Company data, VTB Capital Research*

X5 Retail Group's management estimated that the main effect of the payment terms would come from fresh products (which account for about 30 percent of the company's turnover and have an average 15 days payable). The overall effect on working capital, though, would be marginal.

Pursuant to the Law the Russian Government can impose regulatory measures for essential goods, including food staples, for not more than 90 days, if there has been more than a 30 percent price increase in the last 30 days. Currently, there is an export ban on grain in effect due to an expected crop shortfall (please see Gain Report RS1039 <http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Ban%20on%20Grain%20Exports%20from%20Russia%20Comes%20to%20Force%20on%20August%2015%20Moscow%20Russian%20Federation%208-6-2010.pdf>). Other such declarations in Russia's recent history include Premier Viktor Zubkov's in 2008 before the presidential election, but attempts to freeze prices, particularly for milk, have failed.

The Law stipulates that the terms and conditions of food product supply contracts shall be brought into accord with requirements of the Law within one hundred eighty days from the effective date.

Retailers repeatedly expressed worries about over-regulation of commerce. The Russian ACORT Retailers Association pointed to the risk of a hike in prices and a sharp decrease in the assortment of foodstuffs in Russia. Experts also warned that restrictions on payment delays would make retailers more dependent on banking loans and increase expenses on the payment of interest.

Currently retail chains are gradually adapting their activities according to the Law. And although there has been no noticeable effect yet, some retailers are starting to change their assortment strategy, for example, cutting out duplications in some categories as well as slow moving goods. As a result, the number of suppliers also is being refined and reduced, sometimes in favor of big brands, sometimes in favor of local suppliers. At this time it's difficult to predict who will be most affected. We will likely see more effects of the Law on the market in the close future, when all retail activities are brought into accordance with the Law.